UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

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IN RE: BERNARD L. MADOFF INVESTMENT SECURITIES LLC,
Debtor.
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ORAL ARGUMENT RELATING TO DOCKET NOS:
Docket No. 11-5207
Docket No. 11-5044
Docket No. 11-5051
Docket No. 11-5175
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IRVING H. PICARD, TRUSTEE FOR THE LIQUIDATION OF BERNARD L. MADOFF INVESTMENT SECURITIES LLC,

Plaintiff-Appellant,

SECURITIES INVESTOR PROTECTION CORPORATION,

Intervenor-Appellant,

vs.

HSBC BANK PLC, et al.,
Defendants-Appellees.
----------x

IRVING H. PICARD, TRUSTEE FOR THE LIQUIDATION OF BERNARD L. MADOFF INVESTMENT SECURITIES LLC,

Plaintiff-Appellant,

SECURITIES INVESTOR PROTECTION CORPORATION,

Intervenor-Appellant,

vs.

JPMORGAN CHASE & CO., et al.,
Defendants-Appellees.
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November 21, 2012

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IRVING H. PICARD, TRUSTEE FOR THE
LIQUIDATION OF BERNARD L. MADOFF
INVESTMENT SECURITIES LLC,

Plaintiff-Appellant,

SECURITIES INVESTOR PROTECTION CORPORATION,

Intervenor-Appellant,

vs.

UBS AG, et al.,

Defendants-Appellees.

----------x
IRVING H. PICARD, TRUSTEE FOR THE
LIQUIDATION OF BERNARD L. MADOFF
INVESTMENT SECURITIES LLC,

Plaintiff-Appellant,

SECURITIES INVESTOR PROTECTION CORPORATION,

Intervenor-Appellant,

vs.

HSBC BANK PLC, et al.,

Defendants-Appellees.

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November 21, 2012
10 a.m.
Daniel Patrick Moynihan
U.S. Courthouse
Ceremonial Courtroom
500 Pearl Street
New York, New York 10007

B E F O R E:

HON. DENNIS JACOBS, Chief Judge
HON. SUSAN CARNEY

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JUDGE JACOBS: Judge Winter is on this panel but he is unable to sit with us this morning. He will have the benefit of oral argument and he will participate in the disposition of these appeals.

In doing so, I'll try to lay out a sensible way of hearing the various parties in the Madoff cases.

In Re Bernard L. Madoff Investment Securities, unless the parties have a sensible alternative that is intuitive, we will hear Picard for 20 minutes and SIPC for 15. That will be followed by ten minutes each from the following parties in this order: JPMorgan, Egger, Bank Austria, Pioneer, and HSBC, and then we'll hear Picard for ten minutes and SIPC for five minutes.

I'll read that again because it's very complicated. Picard for 20 minutes, SIPC for 15, followed by ten minutes each and the following five parties: JPMorgan, Egger, UniCredit Bank Austria, Pioneer, HSBC. They will be followed by Picard for ten minutes in rebuttal and SIPC for five minutes in rebuttal.

Does that create a serious problem?

We might as well work this out before we sail into this.

MR. SAVARESE: Yes, Your Honor. John Savarese for JPMorgan. We did confer among ourselves beforehand --

JUDGE JACOBS: And you divided the time?

MR. SAVARESE: We have, and we've divided it by substantive topics. That is, the order that Your Honor is approaching, with some minor adjustment, will make sense.

JUDGE JACOBS: Tell me how it will make sense. If you'd like me to repeat it, I will.

MR. SAVARESE: Yes. I intend to go first on behalf of JPMorgan, precisely as Your Honor said, and my focus will be -- and we discussed this with counsel for the Trustee -- is on the trustee standing case law, the Wagoner and Caplin line of cases and the question of trustee standing.

JUDGE JACOBS: You'll be speaking for how many minutes?

MR. SAVARESE: Ten minutes.

Second, Tom Moloney, representing

HSBC, we would propose to have go second and speak for ten minutes. And Mr. Moloney's focus will be on the SIPA statutory scheme itself.

Third, Mr. Schnabl, representing UniCredit, we would propose to have Mr. Schnabl go third for ten minutes. So we're slightly proposing a change, Your Honor, of the order in which you would call us up to the podium. Mr. Schnabl is prepared to focus on the Redington case and the issues of standing under common law.

Fourth, following Mr. Schnabl, Mr. King, Marshall King, who represents UBS, would come to the podium to talk about any questions Your Honors may have with respect to the contribution theory.

And then, finally, Mr. Velie, representing Bank Austria -- so Mr. Velie is in a different order from what Your Honor has suggested -- would address any other standing arguments.

I think that's a sensible way to sort of order this. We hoped that that would ease the Court's task. We know there are a lot of issues and a lot of parties before you.

JUDGE JACOBS: I was hoping that there would be a sensible proposal. I just wanted to put something out that there would be a framework.

MR. SAVARESE: No, we're glad to have done it.

JUDGE JACOBS: We will do it this way.

MR. SAVARESE: Perfect.

(Recess taken.)

JUDGE JACOBS: At this time we'll hear Picard versus JPMorgan Chase, Egger and UniCredit, Pioneer and HSBC.

MR. WARSHAVSKY: Good morning, Your Honors.

JUDGE JACOBS: Good morning.

MR. WARSHAVSKY: May it please the court, Oren Warshavsky of Baker & Hostetler for the Appellant, Irving Picard. Good morning, Your Honors. We're here this morning -- let me start that again.

For the past 30 years the Trustee, before the district courts below, the Trustee, a SIPA Trustee could bring the exact type of claims that the Trustee brought here. That was

what all courts that had examined these issues had understood the law to be.

What I would submit to Your Honors is that that position is supported not just by the SIPA statute but actually all of the citation that we have in these various cases, whether we look at Wagoner and its progeny, including the Kirschner decision or the In Re Mediators, the Redington decision, of course, as well as some of the decisions in this case, including the Net Equity decision as well as the Rosenman decision.

And what I'd like to do is actually start with the SIPA statute itself. The SIPA statute itself is a customer protection statute and it's different than a traditional bankruptcy statute. The Bankruptcy Code is all about protection of the debtor, protection about creditors of the debtor.

Starting in the '30s Congress realized that the bankruptcy -- then it was the Bankruptcy Act -- did not provide protection that typical customers in the brokerage industry needed. They enacted Section 60 of the Chandler Act, that didn't work, and then in 1970 Congress

enacted SIPA. And it enacted SIPA for the sole purposes -- an overlay to the bankruptcy code -- for the sole purpose of protecting customers.

And the SIPA statute wasn't enacted in a vacuum. It was enacted in -- to work hand in hand with the securities laws, as well as the enactment at the same time of Rule 15c3-3 of the Exchange Act.

Under Rule 15c3-3 of the Exchange Act a broker/dealer is supposed to segregate funds. A broker/dealer, so that when an investor comes and invests, the broker/dealer -- the funds or the securities that are transferred into the broker/dealer's possession remain property of the customer, they remain the property of the debtor.

If a customer of a broker/dealer seeks the return of his securities or her cash, that customer is entitled to it, and 15c3-3 requires it. It requires it by operation of law. That works hand in hand with the definition of customer property --

JUDGE JACOBS: What do you do with the general proposition that a bailee can't be a thief? If you've stolen it, you're not holding

it for bailment.

MR. WARSHAVSKY: Well, I think that's when the bailment arises under state common law. Here what we have is federal law that requires --

JUDGE JACOBS: There's no federal law of bailment, so as far as I know. I hardly remember the state law of bailment.

MR. WARSHAVSKY: Well, luckily I'm not going to recite the state law of bailment. I'll go to the federal law, which in 15c3-3 itself it requires a segregation. It requires the broker to keep property for the customer, and what the broker has is possession of the property, but he holds -- he or she holds it for the benefit of the customer. That's the definition of a bailment.

In point of fact, when you think about a bailment, a bailment really is the lowest level of interest somebody could have in a piece of property, and that's what we have here. The broker has --

JUDGE CARNEY: Why didn't the statute use the term bailment or describe the Trustee as a bailee then?

MR. WARSHAVSKY: Well, I hadn't gone to the SIPA statute yet, but I think 15c3-3 under the Securities Act -- I don't know why it didn't use the word bailment. I wish I could come to you and give you the silver bullet answer to that. I don't have one. It clearly does not use the term bailment.

However, there's no other -- there's no other legal relationship by which that -- I'm sorry -- there's no other nomenclature by which we could use to define that relationship. All the broker has is a possessory interest in that property.

JUDGE CARNEY: I mean, it created a special overlay on to the broker/dealer relationship potentially and a set of rights and duties that were sui generis -- or engrafted maybe on to kind of a bankruptcy setting and a bankruptcy background, and that's why I'm confused about your reliance on the notion of bailment, where that really is not explicit in the statute and doesn't seem to be the premise of the overall SIPA.

MR. WARSHAVSKY: Well, actually, I think it is the premise of SIPA, because what

SIPA does -- if we just looked at the Bankruptcy Code, everything would flow through the debtor. What SIPA does is SIPA defines customer property and customer property -- I was speaking before about the Securities and Exchange Act.

What SIPA does is SIPA comes in once a broker/dealer fails, once a broker/dealer is insolvent, and SIPA has a definition of customer property, which means property that by its nature belongs to the customers, not to the debtor, not to the Trustee, frankly.

And SIPA actually broadens the definition of customer property. It's not just what was segregated in the 15c3-3 account or what was supposed to be segregated in a case like this, but also all property which -- in the possession of the debtor which could have been used or which should have been in that fund, as well as all property that the -- that the Trustee can bring back into the estate.

So, for instance, if -- as in a typical Ponzi scheme or a case like this where one customer's property is stolen and given to another customer, a traditional bankruptcy trustee has no right to do anything or to bring

a cause of action there because it was never property of the debtor.

SIPA creates the legal fiction under 78fff-2(c)(3) and it allows the Trustee to treat that -- for the sole purpose of bringing the avoidance action and bringing property back into the estate, it allows -- it creates a legal fiction which allows the Trustee to treat the property as though it were property of the debtor. It actually grants standing to bring that money back into the estate, with the idea being but not -- I'm sorry -- I guess the main point being, not that it would go into the general estate, not that it would go to the estate of the debtor, but that it would be brought back into the Fund of Customer Property, and the reason that's important here is the way the statute works.

Now, in the Rosenman case it was called -- which is part of this liquidation -- was referred to as the customer property estate, other cases call it the Fund of Customer Property, the statute refers to the Fund of Customer Property, but the money comes into the fund.

And the only people -- or the only entities that can get money from the Fund of Customer Property are customers. The Fund of Customer Property cannot be used to pay off the debtors. And, in fact, when the statute uses the term "customer" for those who can participate in that fund, it explicitly removes shareholders, capital investors, individuals or entities that loan money, debenture holders, it excludes all of those entities.

JUDGE JACOBS: But isn't the issue how the Trustee can go about filling that fund or replenishing that fund, I mean, if you find, you know, money that's available for replenishing the fund in the hands of the debtor, then that goes into the fund?

The question is: Can you go against third parties asserting rights that would, in the usual course, be rights assertable by the customers in order to get that money, put it in the fund and then distribute it according to the Trustee's own internal rules, which we have affirmed, but, you know, they are -- it seems like a different beast.

MR. WARSHAVSKY: Well, I think --

the way the statute is set up is that the Trustee is the Trustee of this estate, the trustee of the fund, and ultimately if the fund is full -- and in this case we're only talking about principal -- if the fund is full, of course, then the Trustee has no more standing on behalf of the fund.

However, in a case which might be six months or eight months or ten months, the Trustee probably could bring back all money in by virtue of avoidance actions, it might be able to.

Here, however -- and I'd like to actually -- to respond to your question, Your Honor, I'd also point to the St. Paul case and the Mediators case in this court because I think those are instructive.

Number one, the statute does -- as a customer protection the statute does put the SIPA Trustee in the position of bringing claims for common injury to the fund. St. Paul breathes life into that, suggesting that when claims are not particularized, that the Trustee is the proper party to avoid -- in this case we have 4900 account holders -- to avoid 4900

different lawsuits, but there's another point here too, which is, when you look at St. Paul and you look at Mediators -- and I think this goes back to the first question too about why it's different then the fund -- I'm sorry -- why it's different than a traditional bankruptcy case.

When you look at the Mediators case, the Mediators case, decided by Judge Winter, actually stood for a few propositions, but one was -- in the Mediators case there were creditors, creditors of the debtor who came and said by virtue of the injury to the debtor, they were going to assert claims.

They were found in pari delicto. Why, because their claims arose through the debtor. Here -- and through damage to the debtor.

Here if we brought -- if customers were to bring their own claim, their claim would be through damage to their property. Again, when we employ 15c3-3 under the Code, the definition of customer property under SIPA, the damage is to the Fund of Customer Property, not to Bernard L. Madoff. And, therefore, if these

customers were to bring the act on their own -- if each one were to bring a lawsuit on their own, no one would suggest that they were in pari delicto. In point of fact, they'd be clean.

JUDGE JACOBS: Sure.

MR. WARSHAVSKY: They, and sorry -- I'm sorry, did I interrupt, Your Honor?

JUDGE JACOBS: I think what you're leading up to is the idea that the SIPA Trustee has some different powers and title than a trustee in a case under Title 11 and we know that that can't be because the statute says that the SIPA Trustee has the same powers as the Trustee under Title 11.

MR. WARSHAVSKY: He does have the same powers but --

JUDGE JACOBS: The same title and the same powers.

MR. WARSHAVSKY: Well, I guess where I would disagree as to title is that in a typical bankruptcy we don't have the fund of customer property. They were a bailment in a typical bankruptcy and the Trustee were to accede to that bailment, the Trustee wouldn't be coming in as the Trustee of the debtor and

bringing claims on behalf of the debtor's property. The Trustee would actually be bringing claims on behalf of the bailed property and that's all we have here.

What we have here is not -- again, I started with the distinction about the Bankruptcy Code being a debtor protection statute. A typical Chapter 11 bankruptcy trustee only brings claims to -- on behalf of the debtor, only property that was property of the debtor, only injury -- only to address injury that was injury to the debtor.

Here we're not talking -- when we we're talking about the SIPA Trustee and solely for the recovery of the Fund of Customer Property, not the general estate, because SIPA does create two estates -- or what I'll call two estates and what I think at least makes sense for discussion purposes and that I think is why the Rosenman court used those terms.

There's the general estate, which is just like any other bankruptcy estate, which may pay off other loans, may pay off fraud claims, and then there's the customer property estate, which particularly in this case all it

is doing is returning to customers their property.

JUDGE CARNEY: Well, except to the extent it's called on to do that pro rata, after assembling more and going after other funds that could properly be included as customer property. It's not really returning the same thing. I mean, there are aspects of this are unlike ordinary bailment, I think you have to agree.

MR. WARSHAVSKY: I agree in the facts of this case, but if we were to take a look at another SIPA proceeding, such as Lehman Brothers, where no one went in and raided the Fund of Customer Property, those were turned back over to the customers.

In fact, when there are specifically identifiable customer name securities, those are returned to the customer. Here it's a bit more like, you know -- one of the cases that was cited -- I know it's an old case -- but it was cited by SIPC had to do with grain. We have fungible -- ultimately here all we have is fungible property. All we have -- there were no securities that were ever purchased. All we have is really -- as you see

the net equity decision, cash in/cash out, and cash being fungible, the only way -- by virtue of the shortfall, the only way to return property is to do it on a pro rata basis.

JUDGE CARNEY: It's still a little inconsistent with the basic notion of bailment, I would think.

Could you go back to St. Paul for a minute and explain how that supports your argument because I see St. Paul as still looking at customer claims that are premised on the existence of the estate itself having a claim, the debtor estate having a claim, as opposed to being independent of that.

MR. WARSHAVSKY: Well, I think -- I'm not -- trying to answer that precisely. I'm just trying to get my words.

In a -- what St. Paul stood for was that if there was a claim that could be brought by any debtor for the same -- for a common injury, the claim belonged to the estate, the idea being not that there -- I'm sorry -- did I say any debtor? I meant any creditor -- I'm sorry -- that if a claim could be brought by any creditor of the estate, then it was property of

the estate.

And the reason for that is actually just like I would say concurrent with the SIPA statute in that we don't want 4900 lawsuits and we don't want a race to the courthouse.

JUDGE CARNEY: Again, wasn't that in the context of a situation where the estate itself clearly had an alter ego claim, so these were addition to that, as opposed to independent of the company's alter ego claim.

MR. WARSHAVSKY: Well, and I think that's right, and I think that's because St. Paul arose in a traditional bankruptcy where all there was was a debtor estate. To the extent creditors would have claims in common, it would be through the injury to the estate itself, or the debtor itself.

Here again the injury to the customers, which is common, which is basically through the deepening of the insolvency here, the injury to all customers is the disappearance of their money and the fact that Madoff declared -- you know, was running a Ponzi scheme. So all customers were injured through those actions. And the claim arises through the

damage to the fund. It's by virtue of the fund not being there.

Did I answer your question?

JUDGE CARNEY: I still see that there was -- that the debtor estate itself had an alter ego claim --

MR. WARSHAVSKY: Right.

JUDGE CARNEY: -- that is not present here and that's why --

MR. WARSHAVSKY: Here in the first four common law causes of action asserted by the Trustee in most of these -- other than contribution causes of action asserted by the Trustee in this case, they cannot -- the customers' claims certainly do not arise through damage to BLMIS. They strictly arise through damage to the Fund of Customer Property.

It's our belief -- but, again, I guess what we would go back to is the Fund of Customer Property is established only for participation by customers and, therefore, what we say is everybody, every customer has a common claim there and it's through that common injury.

JUDGE JACOBS: You're saying the customer has a common claim, but isn't an

element of almost all of your causes of action reliance?

MR. WARSHAVSKY: No, I don't think -- no, I don't think they are. I think that an element to our causes of action might be customers' reliance on Bernard Madoff. What we've alleged in all of our causes of action is really aiding and abetting causes of action.

If you look at the HSBC or UniCredit complaints, what we have is aiding and abetting breach of fiduciary duty, aiding and abetting fraud, and so the reliance by the customers was on Bernard Madoff. I think everybody would agree that innocent customers with a valid customer claim all relied, to their detriment, on Bernard Madoff.

So I guess reliance -- yes, to answer to your question, reliance is an element, but it's reliance on Bernard Madoff, not reliance on these defendants.

If I may quickly turn to -- did I answer both of your questions on that?

JUDGE JACOBS: We have your answers.

My colleague Mr. LaRosa will speak

more to the issue of SIPC's right of subrogation, which is also a standing issue, but I would point out that in both of these cases if we look to -- I'm sorry -- both of the decisions below and in all of these cases, if we look to the plain language of the statute, 78fff-3(a), it is very clear that SIPC's rights of subrogation against the estate are not to the exclusion of SIPC's other equitable subordination rights.

Finally, I do want to go quickly to the Trustee's contribution claims, because the Trustee's contribution claims there we do have to acknowledge that we are stepping into the shoes of Bernard Madoff. The only way -- and BLMIS -- and the only way we can accede to those claims is by virtue of being a joint tortfeasor.

What the Trustee is doing -- I'd like to give a quick example, if I may, of the type of claim that the Trustee has raised because there are specific claims and there are general claims, but here what we've accused some of these defendants of doing is they were custodians for funds, for overseas funds, and they were supposed to hold on to all assets, to

all securities, all cash, and they got paid for that, and that's what gave customers confidence investing into these feeder funds, many of these customers not even knowing that Bernard -- that the money was ultimately going to Madoff.

The money did and the duties, the custodial duties were just transferred to Madoff for free, by the way. Madoff didn't charge these defendants -- may I finish this example? I see my time is running.

JUDGE CARNEY: Go ahead.

MR. WARSHAVSKY: These defendants continued to collect their fees but had basically delegated Madoff as their agent. And our -- and now the funds themselves have claims in this bankruptcy for billions of dollars against this -- in this -- against -- in the Trusteeship -- I'm sorry -- in this liquidation. And the Trustee's position is, to the extent that the Trustee has to pay those claims, these defendants, these custodians who were supposed to be holding the assets are joint tort feasors and at least responsible for a share of the damage and to pay for those claims.

JUDGE CARNEY: My understanding of

New York law -- if I could have a second -- is that if a joint tort feasor is going for contribution against a fellow, that you need to have paid up to at least your pro rata share before you can have sustained the right of contribution.

How do you reconcile your client's situation with that?

MR. WARSHAVSKY: Well, actually under New York law to collect -- to actually enforce a contribution judgment, we'd have to pay more than our fair share, but under New York law -- and we cited cases, and I'll bring the case to you when I come back up on rebuttal -- but it's very clear that the action may be maintained from the outset. The right of enforcing what we'll call the contribution judgment only can occur once the Trustee has paid more than his fair share.

What I'll also note is that in this case the Trustee has satisfied the claims of 800 customers -- not of every customer -- but of certain customers. But, as I say, under New York law -- and I will gave you the case names -- New York Court of Appeals is very clear that

a defendant may maintain his or her action up until and only is precluded from collecting the money -- until he or she has paid more than his or her fair share.

JUDGE CARNEY: Thank you.

MR. WARSHAVSKY: Thank you.

MR. LA ROSA: Good morning, Your Honors. Mr. LaRosa on behalf of the Securities Investor Protection Corporation.

I would like to focus on two things: Bailment and subrogation, those were the topics we addressed in most detail in our briefs, but bailment with particular reference to the bailment created during the pre-liquidation period, because it's really the pre-liquidation bailment that's created by the interaction between both 15c3-3 and the common law of bailment that carries over into the SIPA liquidation and enables the Trustee, the successor to the bailee status of the broker/dealer, to serve -- you know, to bring actions as the bailee of customer property.

There are only two things that are required for a bailment implied in law and that's what we have here: Lawful possession,

however acquired, however acquired -- and that is the language that's found in the case law -- and a duty imposed by law that the bailee account for the property in question as the property of another.

Rule 15c3-3, with respect to property received by a broker/dealer from customers, creates exactly those conditions.

Under the rule, a customer -- quote/unquote -- and that's a term of art -- is any person with whom a broker/dealer has an account relationship and from whom or on whose behalf a broker/dealer has received required funds or securities. When the broker/dealer has established a customer relationship, the broker/dealer has not only the right but the obligation to reduce to possession funds and securities tendered in the context of the account relationship.

So that obligation exists and that obligation exists, importantly, irrespective of what the broker intends to do with it. The broker's obligation is, once the property is acquired apply, irrespective of the broker's intent with respect to that property then

imposed by law.

So the broker's possession of property tendered in the context of an account relationship is lawful without regard to whether or not the broker intends to steal the property, comply with Rule 15c3-3. It is a lawful -- it is, in effect, a determination that, as a matter of law, possession is lawful by virtue of the nature of the relationship between the parties. So the -- in our view, the element of lawful possession is satisfied once the nature of the relationship is established.

It's also clear that there is a duty on the part of the broker/dealer to account for the property received as the property of another. The broker/dealer is required to hold in its possession at all times securities of the type and in the quantity owed to all customers. They don't have to be the same securities tendered by the customers because the law recognizes, as bailment law recognizes, that fungible property can be substituted.

There's no reason why a broker/dealer should have to segregate the same dollar tendered by a customer because one dollar

is just like another; in the same way there's no reason why a broker/dealer should have to segregate a share of Xerox that is the same class and issue as any other share of the same class and issue, they're identical, they're functionally identical. So you have all of the elements that are necessary for a bailment implied in law.

Ratable distribution -- I think there was a question about ratable distribution. That is consistent with bailment. When you have bailment that -- and I think it's important to recognize, both 15c3-3 and SIPA treat the bailment that's created as, in effect, a collective bailment. The bailors, the customer bailors collectively bail their property with the debtor bailee.

When you have a collective bailment and when fungible property that's collectively bailed is co-mingled and is lost, bailment law provides that the remaining property will be distributed ratably to the bailors. And you see this most commonly, I think it was mentioned in the commodities cases that come out of the midwest. A bunch of grain producers all take

their grain to the same warehouseman and all the grain is dumped into the same grain silo and a tornado comes along and blows the roof off and half the grain is gone.

Well, it's okay to co-mingle the property because it's fungible and it's segregated on the books and records of the warehouseman, so the warehouseman knows exactly how much grain goes to each party, and that conforms with the segregation requirements imposed by bailment law.

And you can't distribute the property that's left any way that's fair except ratably, that's the only way to do it, you know, consistent with fairness. So it's been recognized in a number of cases that where you have that fact pattern, which is what you typically have in a SIPA liquidation, ratable distribution is appropriate and is consistent with bailment.

With regard to subrogation. SIPC has subrogation rights that come from two sources: The common law and the statute. The statute provides expressly that SIPC shall have subrogation rights. There's nothing in the

statute that says that those rights are limited to claims against the customer fund. In fact, the only limitation is a temporal limitation. SIPC can't assert its rights until after the Fund of Customer Property has been allocated.

Well, of course, that makes perfect sense. It wouldn't -- you know, to the extent -- SIPC has a claim against the customer fund as subrogee but it doesn't mean that just because it has a claim against the customer fund, it doesn't have a claim against anybody else. And certainly vis-à-vis its claim against the customer fund, it can't assert that until customer property has been allocated. It wouldn't -- it would be crazy -- in effect, it's stating the obvious, but there isn't any other limitation and to read into --

JUDGE JACOBS: Does SIPC get the -- what's left or do they take first dollar?

MR. LA ROSA: SIPC stands in the -- SIPC will only collect against -- vis-à-vis the customer fund you mean?

JUDGE JACOBS: Yes.

MR. LA ROSA: Yeah, SIPC will stand -- will only collect with respect to

customers who have been satisfied in whole. So SIPC stands in the shoes for purposes of recovery against the customer fund of the customers who have been satisfied in whole. Remaining customers, you know, have -- the so-called over the limits customers acquire their ratable share based on -- whatever that is -- based on their, you know, the amount of their claims and the proportion of their claims.

There's certainly nothing and there's neither anything in the language of 78fff-3(a) and nothing in the legislative history to the section that suggests that beyond its statutory rights, that SIPC's common law rights of subrogation are in any way limited. The statute, in fact, on the contrary, says that SIPC shall have all other rights that it may have in law and in equity.

Now, the defendants here try to make a big deal about how this was a technical amendment, and so on, but it was technical only in the sense that it codified what had been established in Redington and what had been understood to be SIPC's common law rights --

JUDGE JACOBS: But do I understand

then that the SIPA Trustee seeks to replenish the customer fund for the benefit of SIPC in terms of the last dollars that would come into that fund after individual customers have been satisfied in whole?

MR. LA ROSA: The -- in --

JUDGE JACOBS: In other words --

MR. LA ROSA: Yeah, go ahead.

JUDGE JACOBS: -- is it 20 percent up to a certain amount, is that it? What's the compensation from SIPA?

MR. LA ROSA: It's up to 500,000 for a claim for securities.

JUDGE JACOBS: Up to 500,000?

MR. LA ROSA: Yeah.

JUDGE JACOBS: Well, let's say it's a million, then the first half million that goes in allocable to that customer goes directly to that customer?

MR. LA ROSA: Well, as I say, if that customer were -- let's take the hypothetical where you have no property in the Fund of Customer Property or where you've got a property that -- SIPA's made its advance of a half million dollars --

JUDGE JACOBS: Let's says it's all been stolen.

MR. LA ROSA: -- it's all been stolen, some money now comes in. How do we allocate that?

JUDGE JACOBS: Yeah.

MR. LA ROSA: Anybody with a -- SIPC would stand in the shoes of any customer with a claim of $500,000 or less. Any customer with, say, a million dollar claim would receive all of that -- all of the property until -- well, all of it until -- their ratable share. SIPC only stands in the shoes of those --

JUDGE JACOBS: But SIPC would only collect a dollar after the million dollar loss has been replenished to the tune of half a million?

MR. LA ROSA: In the case of one customer, yes, correct. If there were one customer. If there's were other customers, yes, SIPC --

JUDGE JACOBS: That's all I'm asking.

MR. LA ROSA: Yes, that's right. We've said -- there's another

reason, of course, why SIPC's subrogation rights are -- or the enforcement of SIPC's subrogation rights against third-party is compatible with the distribution scheme, and that is that SIPC is prevented by statute from interfering with the Trustee.

I mean, if SIPC is seeking to recover customer property, SIPC is stayed by the automatic stay from bringing suit. That's a suit that has to be brought by the Trustee. If SIPC somehow were to recover customer property, SIPC would have an obligation under the turnover provisions of the Bankruptcy Code to give it to the Trustee.

Either way, the property that's -- the customer property that is recovered is going to be distributed through the allocation scheme provided by SIPA and SIPA -- SIPC wouldn't and doesn't have the power to put itself in front of customers.

Thank you.

MR. SAVARESE: Good morning, Your Honor. My name is John Savarese from Wachtell, Lipton, Rosen & Katz, I'm counsel for Appellee JPMorgan. And consistent with allocation of

responsibilities that I outlined at the outset, I'm going to concentrate my time on explaining why this court's precedents concerning trustee standing compel affirmance of both Judge McMahon's decision and Judge Rakoff's decision on standing grounds.

In doing so, I'm going to talk about a line of cases that, interestingly, my friends on the other side have not mentioned, and that is the long and unbroken line of decisions begun by the Supreme Court in Caplin in 1972 and then continued thereafter consistently over two decades by this court, in which this court has definitively determined two critical propositions: Number one, that a bankruptcy trustee has no standing generally to sue third parties on behalf of the estate's creditors; and, two, that the Trustee stands in the shoes of the debtor and can, therefore, only maintain those actions that the debtor itself could have brought before the bankruptcy.

Now, every single time this court has confronted an argument brought to it by a trustee, saying that the trustee should be permitted to bring claims against third parties,

to hold those third parties responsible in part for injuries suffered by the bankrupt corporation's customers or creditors, this court has rejected that argument.

And every time --

JUDGE JACOBS: Accepting then that a bankruptcy trustee stands in the shoes of the debtor because the fund is the bankrupt estate. I think your adversaries are arguing that the SIPA Trustee stands in the shoes of the customer because what you're looking at is a Fund of Customer Property.

MR. SAVARESE: Right. Let me turn to that.

The fact that the Trustee is proceeding here under SIPA rather than under the Bankruptcy Code does not mean that the Caplin, Wagoner doctrine, which basically determines trustee standing by asking the question: Who owns the claim? It's a simple straightforward test: Who owns the claim? That test does not go out the window simply because we're here before Your Honors talking about SIPA, and the reason is grounded in the language of the SIPA statute itself.

SIPA says -- and I believe Your Honor, Judge Carney, mentioned this -- it plainly states that SIPA Trustees -- and now I'm quoting -- "have the same powers and title with respect to the debtor and the property of the debtor as the Trustee under Title 11," the Bankruptcy Code.

It goes on to say that, "to the extent consistent with this chapter, a liquidation proceeding" -- which is what we're talking about -- quote, "shall be conducted in accordance with and as though it were being conducted under Title 11," again, the Bankruptcy Code.

So the same rules that this court has developed over many years to refine and define the limits of an ordinary bankruptcy trustee standing, rules that this court has announced and enforced in the whole Wagoner line, must apply to SIPA trustees by the terms of the SIPA statute itself.

All -- and coming back now to Your Honor's question -- all that SIPA does differently from the Bankruptcy Code is simply move customers up the priority payment scheme.

That's all that's really different.

At the end of the day those monies still come out of the debtor estate, and this statute never says a syllable about bailors, bailees, bailment -- you can search high and low in the statute and you will not find those words -- nor does it create -- nor is there any legislative history to suggest that it creates some new juridical entity called a customer property estate that has some new broad, roving commission to bring all these claims.

I'm sorry, Your Honor.

JUDGE JACOBS: I take it then your argument is is that a bailor is simply someone who moves up in the line? I mean, if your lawnmower is being repaired by a lawnmower company that goes broke, you have a superior claim on your lawnmower.

MR. SAVARESE: Precisely. All that the customers get under SIPA is moved up the payment line, that's plainly what the statute said, but that doesn't mean that the definition of customer property, which simply is the cash and the securities held in the broker's accounts, somehow becomes some new juridical

entity that has some new power that Congress never gave it to bring lawsuits.

JUDGE CARNEY: Isn't it accurate to say, though, that it has some different characteristics in that, you know, membership fees are collected and a fund is created, the SIPC contributes up to half a million dollars per individual account, creating a body that is something greater and different from the regular bankrupt estate?

Isn't that right?

MR. SAVARESE: I agree, Your Honor, that SIPC is a new entity created by the statute, but I would say again in response that SIPC is a creature of this statute. It, therefore, has to look to and be defined by and be limited by those grants of power that Congress gave it. Those grants are limited, they do not overturn Wagoner, they do not overturn Caplin.

JUDGE CARNEY: How do we deal with Redington?

MR. SAVARESE: Well, I hate to trample on the toes of my good friend Mr. Schnabl who is --

JUDGE CARNEY: I'm sorry --

MR. SAVARESE: -- our Redington expert, but I would say two quick things, Your Honor, if you'll permit me.

Number one, we believe that Redington is simply not good law, that Judges Rakoff, Judge Pollack and Judge McMahon got that right; and, two, even if somehow Redington still has a pulse, if it's on some legal equivalent of life support, notwithstanding that the Supreme Court reversed and then the panel on remand vacated and the panel on remand determined that there was no jurisdiction and dismissed the case entirely, even if it somehow still survives, there are two independent reasons why it is not controlling here.

Number one, Redington's bailment theory was invoked in a case where the trustee had expressly asserted that the Weiss securities brokerage itself was an innocent victim, in other words, a very, very far cry from our case where BMIS was an active participant in, was totally controlled by Bernie Madoff. Those are not my words, those are the Trustee's words.

So, importantly, the Redington

panel simply never had occasion to consider -- and, therefore, never decided -- whether the New York black letter law that Judge Jacobs referred to, the law that says a thief can never be a valid bailee, was not at issue there.

Unlike the trustee in Redington, therefore, the Trustee here, who is the successor to a massive thief, Mr. Madoff and his firm BMIS, is not and cannot be under New York law a valid bailee, a wholly independent reason to distinguish Redington.

Second reason to distinguish Redington, very briefly, is that simply to the extent it had standing decisions, those standing decisions were solely related to whether the trustee could bring implied causes of action under Section 17 of the '34 Act, when we knew and learned from the Supreme Court that that decision -- that threshold decision by the panel in Redington was erroneous, then those subsidiary standing decisions I think go out the window and have no force here.

Let me go next, if I may, to St. Paul because Your Honor asked a good question about St. Paul, and I think you have St. Paul

exactly right.

The Trustee here seeks to escape from Caplin and Wagoner by arguing that St. Paul, a decision from 1989, somehow created this wholly new concept of generalized injury standing for bankruptcy trustees that is again somehow broader than the defined scope of trustee standing that has been set forth in the Caplin case and the Wagoner case and on. St. Paul simply does no such thing.

Indeed, this court said as much in Pereira versus Farace, the decision from 2005. In there this court specifically ruled that St. Paul -- and I'm now quoting -- does not imply that the Trustee's rights are greater than the rights of the debtor corporation. And then it went on to reaffirm its adherence to Caplin and Wagoner cited in Farace, and it concluded that a bankruptcy trustee has no standing generally to sue third parties on behalf of the estate's creditors but may only assert claims held by the bankrupt corporation.

JUDGE JACOBS: What is a general claim within the meaning of St. Paul? What is it talking about? It's very difficult to tell.

MR. SAVARESE: Right. I think, first of all, it's dictum. The holding of the St. Paul case -- if you go back and examine the case -- the holding is a completely unremarkable holding. All it says is that as a matter of state law, there Ohio law, the alter ego claim belonged to the debtor estate and therefore was perfectly normal for the trustee to be able to pursue it, because, again, you asked that Wagoner question: Who owns the claim? In St. Paul they said the debtor owns the claim, therefore, the Trustee has standing.

JUDGE JACOBS: Well, in St. Paul there was some quirk of Ohio law.

MR. SAVARESE: I don't know whether it was a quirk or not. I mean, all of the Wagoner cases, Your Honors, say we look to state law. You look at Hirsch, you look at Wagoner, you look at Judge Winter's opinion in Mediators, over and over and over again this court has looked to state law to answer the question who owns the claim.

In our case, no question about it, the creditors, the customers of the failed brokerage, BMIS, they own the claim. These are

individual direct claims. There's nothing derivative about them. This is an individual injury that each of them suffered, each of them made a decision at a particular time to invest particular amounts of money.

If the duties -- the fiduciary duty of the brokerage was owed to them and it was in the end their money that was stolen by Madoff and by BMIS. So there's no question here, and neither Judge Rakoff nor Judge McMahon thought there was any question about the fact that under New York state law the claims we're talking about here, the claims that the Trustee purports to bring, are ones that belong exclusively to the creditor. And in applying Wagoner in its unbroken line of cases, you are led ineluctably to the conclusion that the Trustee cannot bring that kind of claim. He cannot aggregate this mass of individual direct claims belonging to customers in the guise of SIPA and bring this massive case.

Those individuals can choose -- exactly as the Supreme Court said in Caplin, individuals can choose whether or not they want to bring those kinds of cases and --

JUDGE JACOBS: Those cases -- some of them are pending, they're just subject to the automatic stay?

MR. SAVARESE: Yes, there's a whole host of cases out there where individuals of various sorts and institutions of various sorts have chosen to bring claims against third parties. No one would say they don't have standing. They, indeed, very consistently with Wagoner, we would agree that they have standing. We passionately think on the merits with respect to JPMorgan that they are wrong about us --

JUDGE JACOBS: I'm not surprised.

MR. SAVARESE: -- but that question is not before this court.

I see that the red light is on. If Your Honors have any other questions for me, I'd be happy to address them.

JUDGE JACOBS: Thank you very much.

MR. SAVARESE: You're welcome.

MR. MOLONEY: Good morning, Your Honors. My name is Tom Moloney and I'm going to be speaking on behalf of the HBSC -- HS -- I guess HSBC defendants -- and, as Mr. Savarese said, I'm going to focus on the statute, though

to the extent he already covered some of the statute, I'm going to try to do a deeper dive into some of the provisions I think are specifically going to be helpful to the court in answering some of the questions you've asked so far this morning, but before that I want to make had a couple of big picture points.

One big picture point is -- relates to the whole issue of whether the SIPA statute creates a separate customer fund that is not property of the debtor. That is absolutely incorrect. If you look at the statute, the property is still property of the debtor, it's just a priority, or, as the Supreme Court said in Holmes, the claims of creditors are subordinated to that property, and this court has actually ruled precisely -- in a case precisely on point on that issue, in the Rosenman case. In the Rosenman Family case, which was decided by SIPC, this court dealt with the situation where -- involving Madoff where a customer sent money into Madoff ten days before the broker/dealer ended up filing for insolvency, and then he said I want it back, just like they said he could get it back because

it's not the debtor's property. And this court said, no, it's the debtor's property, we'll decide later on whether or not you qualify as a customer and have priority. That's a separate issue which the panel said we can't decide now on this record, but that's the debtor's property and that's the way the statute works. So it's the debtor's property.

The second big picture point I think is important to make is I think bailment is in many ways a red herring here. The statutes that they're referring to only create a bailment in one limited circumstance.

15c3-3 is a rule that allows a broker/dealer to use cash and securities in their business. If you read through the rule, it allows them to pledge it, it allows them to repo it, it allows them to use it in all kinds of activities, to make it available to people who are doing short sales and then they have to put money in an account to make sure that they can get it back or potentially satisfy the customer's claim otherwise. It's a customer protection rule, but it has nothing to do with bailment, it doesn't mention bailment, it

doesn't create any rights to bring suits on behalf of the customers.

Similarly, the SIPA statute creates only one form of bailment. That's for customer name securities. If you provide a broker/dealer with customer name securities -- I've been a SIPA Trustee in three cases. I've never seen it. I don't think it even happened in Lehman, didn't happen in Madoff, very rarely does someone actually create customer name securities, you can and if you did, then that's a true bailment is established --

JUDGE JACOBS: Could you explain that because I'm not sure I follow what that is?

MR. MOLONEY: If you actually tell the broker/dealer that the securities could be registered in your name so title is not actually transferred to the broker/dealer --

JUDGE JACOBS: So the broker/dealer can't use it for any --

MR. MOLONEY: Correct, can't use it for any purpose. Nobody does this. That's the only bailment that the SIPA statute creates. Otherwise, it creates a different scheme. It creates a scheme of priorities and, as Your

Honor pointed out, of distributions, and it does not return you necessarily your property. Even in Lehman they did not necessarily return property. If it's unreasonable for the broker/dealer to go out and buy securities because of market disruption, you could return cash rather than property. If there's a margin account and you didn't pay back the margin, you don't get back your property. There's all kinds of rules there. It's a regime of customer protection, but it's not a bailment.

In fact, the whole point of these statutes was to move away from the common law bailment. One of the statutes was bailment was difficult because then you had to identify your property, it put limitations on the ability of a broker/dealer to use the property, it gave duties to the broker/dealer or to Mr. Picard, I'm sure he's not carrying out at the moment.

This court and the Southern District Court has often said that a trustee is not a substitute broker/dealer. So he's not acting as a bailee. He's acting pursuant to a statutory scheme. So I think those are a couple of big picture points.

One other big picture point I would make is about St. Paul. I think the most important thing to understand about St. Paul is in that case what was happening is the corporation itself suffered an injury. It was being deprived of its assets.

So if you strip assets away from a corporation, every creditor of the corporation will indirectly suffer harm as a result of the direct harm to the corporation. That's what circumstance St. Paul dealt with.

Those are not the claims here. To put it in context and answer a question Your Honor asked, our client, HSBC, did not provide any services to Madoff. We had no duty to Madoff. We provided custodial or administrative services to 12 so-called feeder funds who, you know, they were foreign funds, they're foreign hedge funds, investors invested in those funds and those funds, in turn, made investments into BLMIS.

We're being sued all over the world by those funds and by those investors and we're defending those lawsuits, but they're the parties who, if anyone was injured by our

failure to carry out our duties as administrator or as a custodian, were directly injured by that injury. And the Trustee who's sitting here, he has suffered no direct injury whatsoever as a result of what we did. We provided him with just more money into his estate.

JUDGE JACOBS: Well, hypothetically assume you have a bank that did violate the law, that was hand in glove with the Ponzi schemer, a big bank, how would SIPC get its money back from such an entity, either by subrogation or by suit, or whatever, or does it have to just wait until the customer hits the jackpot, collects every dime and dollar, and then take its money from that judgment?

MR. MOLONEY: I think there's really three answers to that, Your Honor, in this case.

JUDGE JACOBS: One will do.

MR. MOLONEY: The three answers to that in that case is -- the first answer is that in our case the customers -- the investors, the foreign investors, are not customers so SIPC is not paying them.

The 12 feeder funds, they're suing

11 of them, so SIPC is not paying them either. So SIPC is not advancing funds for these people. The money for whom SIPC is --

JUDGE JACOBS: But my hypothetical dealt with --

MR. MOLONEY: In a hypothetical situation -- in a different situation where they -- so I'm just talking about in our case, the case involving HSBC --

JUDGE JACOBS: But you're talking also generally about the SIPA scheme?

MR. MOLONEY: In the bigger scheme of things, SIPC's rights are specifically defined as a subrogation right to the net equity claim against the broker/dealer. Those claims -- that money will come out only after all other net equity claims have been satisfied.

Additionally, to the extent SIPC pays the administrative costs of the estate and pays the fees of the lawyers involved, that money will come out ahead of all unsecured creditors as to an administrative claim and anything that's left over.

That's what the statute provides, for SIPC to get the money back that is provided

in advancing of the scheme. It does not -- to the extent SIPC has some additional independent claim, but not a subrogation claim, it can bring that claim against parties, it's tried to do that --

JUDGE JACOBS: It's not a -- it kind of looks like it would be a subrogation claim, doesn't it?

MR. MOLONEY: Yes.

JUDGE JACOBS: I mean, you make good someone's loss to the tune of half a million dollars and then -- and if there's a person who's committed wrongdoing who is sufficiently deep pocket to pay it, why can't SIPC replenish its funds and repay the taxpayer?

MR. MOLONEY: I think Holmes dealt with this in part, Your Honor, in saying that to try to imply an additional equitable subrogation right to SIPC raises a lot of unanswered questions, and I'll just mention a few of the them here.

One thing before I do is, they were not correct in saying there's no legislative history on point. Legislative history is cited in JPMorgan brief at Page 51 which indicated,

the claims of SIPC as subrogee, except as otherwise provided, should be allowable only as claims against the general estate. That was a SIPC task force before the statute was enacted. So they understood that they were getting a limited right.

I think the legislation is clear, as pointed out in the opinions, but the legislative history is also clear that they understood they were getting a limited right. But if you want to posit that they have this additional right beyond what the statute provides, then you have to ask the first question is: Who are they subrogated to? The person who was the -- who took out the insurance was BLMIS, the person who actually pays the claims is BLMIS.

So if they're subrogated claims of BLMIS against other parties, they're going to be standing in the same in pari delicto defense that we have against BLMIS.

The second question --

JUDGE CARNEY: I'm sorry, when you say who took out the insurance, you mean who participated as broker/dealer in creating the

fund that SIPC --

MR. MOLONEY: Well, broker/dealers created the fund and they created the insurance for the broker/dealer, BLMIS. SIPC doesn't actually pay any claims. All they do is advance money to this broker/dealer so that it pays a portion of a net equity, not the real claim.

So you got a situation as to do they actually have a claim against somebody else other than BLMIS. Then of course, Your Honor, you have the New York State's rule about make whole which is that for this other claim they would also have to wait until these funds and these investors actually were made whole before they could actually bring a claim under New York equitable subrogation law, if that's what they were relying on.

You know, whether or not they're relying on New York -- Holmes said that, look, we can't start figuring this out. The statute gave them a specific right. They had not articulated a theory that gets them a broader right.

If you look at the facts of this case, I don't -- they don't have -- the people

they've been subrogated to never heard of HSBC, many of them may have invested before HSBC even was involved in the case, in terms of talking about reliance. You'd have to bring a claim on behalf of 2000 people, each one would have a different story against someone who didn't have any dealing with them.

By comparison, the funds who are suing us and the investors who are suing us directly, you know, for the same $9 billion -- they're all three groups are suing us for the same $9 billion. And the Wagoner rule kind of allocates who has standing and says that, look, between these three groups the person who has standing is the person who was directly injured.

Your Honor, I think that's the rule that has to apply here.

JUDGE JACOBS: Is there a reliance element to any of the claims that are being asserted against your client?

MR. MOLONEY: Of course there's a reliance element, Your Honor. You know, the aiding and abetting fraud. What fraud did we aid and abet and how did we aid and abet the fraud? Someone who invested five years before

HSBC was even involved in any way in this scheme, how could they say we aided and abetted a fraud as to them? How did we aid and abet any misrepresentation that was made to them at that point in time?

So I think that someone who's never heard of HSBC, who did not come through one of these 12 feeder funds, how could they say that we somehow aided and -- that they relied on our involvement in any way or that we aided and abetted any statement that they relied on by Bernie Madoff?

So I think reliance -- I think Your Honor is dead on that reliance is exactly on point and it's why -- it's why -- it's what animated Wagoner's decision, as Your Honor is aware.

In Wagoner they said that, look, the company couldn't rely on the false reports of the accountants, the company produced the phony books. That's the case here. They produced the phony books standing in the shoes of the debtor, which is what they stand in the shoes of for purposes of bringing these type of claims.

JUDGE CARNEY: One quick question before you sit down, if I may.

MR. MOLONEY: Yes.

JUDGE CARNEY: Is the fund that SIPC draws on to pay harmed customers, is there any taxpayer money in that or is that all broker/dealer membership fees?

MR. MOLONEY: It's all broker/dealer membership fees, Your Honor, which they raised and then they stopped when they thought they had a billion dollars and it was enough, and then they had Lehman and they had Madoff and now they're raising those fees again over -- but all broker/dealers pay a fee --

JUDGE JACOBS: The government is never on the hook for this?

MR. MOLONEY: The government is never on hook. There's a provision that says that the government can make --

JUDGE JACOB: Even after the money is used up?

MR. MOLONEY: Yeah, there's a provision that says the government can loan to SIPC of up to a certain amount of money. And that's -- I think it's up to $300 million

dollars, last time I remember looking at the statute, but they have to pay it back.

So the government is not paying this money. It's the broker/dealer community is paying the money.

JUDGE JACOBS: Thank you.

MR. MOLONEY: Thank you, Your Honor.

MR. SCHNABL: Good morning, Judges. My name is Marco Schnabl. I'm with the Skadden, Arps firm and I owe Mr. Savarese a commission for having addressed some of the subjects.

I will briefly rise simply to urge the Court to leave a case, Redington against Touche Ross, where it is, as we said, deader than a doornail. It is a case that was reversed by the Supreme Court, it was vacated by this court and then dismissed by this court and I need to go --

JUDGE JACOBS: And you don't think it's persuasive?

MR. SCHNABL: I will get to that. It is neither binding nor is it persuasive.

JUDGE CARNEY: Just one second. You said it was vacated by the Supreme Court, it

was, but it made -- there were holdings that were not addressed by the Supreme Court. Isn't that correct?

MR. SCHNABL: I may have misspoken or not said it correctly. It was vacated by this court, not the Supreme Court. It was reversed by the Supreme Court and then it was vacated by this court in its entirety, and then it was dismissed for lack of subject matter jurisdiction at the end of the process, and let me go through it so this is placed in context.

In Redington -- by the way, it is worthwhile observing that this 35-year-old case is being resuscitated every time by SIPC and Trustee when they want to ask for courts for these implicit rights that they've had 35 years to ask from Congress and that have never gotten.

That is an interesting observation because counsel for SIPC said that a certain provision codified what -- in the '78 amendment codified what Redington said. It must have been a very insightful codification because the legislative history long precedes -- that says that it was a technical amendment -- long precedes the opinion in Redington.

In any event, in Redington three giants of this court: Judges Lombard, Judge Timbers and Judge Mulligan, engaged in the kind of debate that made them the giants they were.

And in that case this court held that there was a private right of action under 17(a) on behalf customers of the failed broker to sue an accountant that was in direct privity with that broker.

Having invented a cause of action that the Supreme Court later told us did not exist, they had to invent a plaintiff, and the plaintiff they invented was the Trustee as bailee of customer property and SIPC as an equitable, equitable subrogee to bring to assert these claims.

The Supreme Court takes the case and reverses on the threshold issue of the existence of a right of action under 17(a). Those were the heady days of '78 when private right of actions existed behind every word and every statute. The Supreme Court says there is no private right of action. It comes back to this court and then judge -- the three panels, three panel, not a clerk, not a single judge,

the three judge panel vacates the entire judgment.

The litigation continues for a period -- to the end of '79 because there is a parallel state proceeding in which these common law claims -- common law claims against the accountant are being brought and trustee and SIPC wanted to be in federal court. They say there must be some form of jurisdiction to bring these cases here, some plenary jurisdiction, and the court finally, the same panel in what we have called Redington 3 at 612 F.2d 68, says, no, absent 17(a) there is no subject matter jurisdiction in this court and affirms Judge Wyatt's original dismissal of the case.

And let me observe that when Judge Lombard writes the opinion saying there is no subject matter jurisdiction, he characterizes the Supreme Court as having reversed the decision to allow the trustee to maintain a private right of action. He goes well beyond saying it has reversed the existence of 17(a).

Now, is this a binding decision, is this a decision to which this tribunal has a stare decisis obligation? I suggest it is not

for any of the following three reasons, let alone all of them collectively.

It is vacated and we've offered case law for the proposition that a vacated opinion absolutely has no precedential value. The court -- this court found that it had no subject matter jurisdiction and, therefore, on an elemental understanding of that conclusion, we know that it had no power to speak on the matter, and, therefore, what it did say really is a nullity.

Number three, the -- all the rulings are stripped of precedential value by the fact that the Supreme Court reversed on what is a threshold issue, the existence of the cause of action, and we have offered cases like Newdow, Picard against JPMorgan, LaBarbrea, Gutierrez all in our submissions that document why these three reasons, independently and collectively, strip the case of precedential value.

The question then is: Is it a persuasive case? And let me suggest the reasons my distinguished colleagues have said, it simply isn't persuasive --

JUDGE CARNEY: Excuse me, before you get to persuasiveness, I noted that in the BDO Seidman litigation in the year 2000, we discussed Redington at some length, and I wonder if you could address the meaning of that, please.

MR. SCHNABL: Absolutely. I'm jumping ahead because that's a question I was going to observe, that in the sphere of cases to which this court might arguably have some stare decisis observation, I know of only two. BDO Seidman is one and it was written, as I remember, by now Justice Sotomayor. And the one thing that is clear is that this court didn't endorse Redington, it simply assumed Redington to be the law, and then proceeded to dismiss on 12(b)(6) basis.

It did not offer an opinion, as I read the case, as to the accuracy, the controlling power or the persuasiveness. It didn't have to. It dismissed on 12(b)(6) basis and the issue really wasn't decided.

Then there was Holmes, Your Honor. Coming from the Supreme Court it is sometimes regrettably binding on this court, and it is

touted as having endorsed Redington.

In fact, it did no such thing. Not only did it say that the SIPC subrogation theory is fraught with all manner of unanswered questions and then went on to decide this RICO case on proximate cause, it specifically said in footnote 17 "we express no opinion."

Now, in English that means we express no opinion about Redington. It simply observed the existence of Redington and expressed no opinion.

So as far as I'm concerned, I am not aware of any case to which this court owes some form of stare decisis respect that has ever endorsed Redington, wholly apart from its lack of binding value.

So it requires me to say: Why isn't it persuasive? Well, I'm tempted to start with what is dangerous because you, Judge Jacobs, ask how does SIPC get its money back.

Well, that is -- betrays a temptation of statutory improvement that the Supreme Court said in Redington one ought not to engage in.

JUDGE JACOBS: Well, we do our

best.

MR. SCHNABL: I understand.

As Mr. Moloney discussed, this isn't the government's money. This comes from the industry. It's just not there in the statute. What the statute provides is what Mr. Moloney discussed, subrogation rights against the estate.

So let me observe that it is not persuasive, even in those aspects which deal with standing, because it really, in adopting both of these conclusions, suffered from the same vice that the Supreme Court said it had suffered in 17(a). And we can see it because, frankly, Judge Mulligan was declared to be right, I knew him to be right, as the Supreme Court said, and then he became a partner at Skadden, so he's doubly right.

Another reason, let me say, there is no room, as Mr. Savarese said, to extend it, to extend Redington, even if it were a good law to the entirely particularized world of these multitudinous claims when, in fact, the narrow holding in Redington is that there is standing with respect to a direct claim of a regulatory

nature against someone with privity.

None of these have privity. We are a parent of some investment advisor somewhere in Europe. The multitudinous difficulties of extending the Redington decision to this context were recognized by Judge Rakoff.

The bailment theory, we have talked about the bailment until we are blue in the face. There is no real bailment. There is a discussion about bailment. 15c3-3 doesn't speak about bailment. There isn't any bailment here. They're trying to sue third parties and return it according to SIPA's structure. There is no return of property to particular customers that can be identified as their property. Even if it is fungible, it is going to be distributed under the SIPA structure.

The entire construct of this equitable subrogation clashes with the very structure the '78 amendment put in place, as Judge Rakoff determined, because it is inconsistent with the priority that puts SIPA below the customers.

As my time is over, I will also call to Your Honors' attention, because we have

discussed it before, and given the way we're doing this, there is a temptation to improve on my colleagues -- I call to Your Honors' attention 78lll for the definition of customer property because it is a good habit actually to read the statute.

It says it's cash and securities, and then goes through each of these categories: Securities, resources, cash, and the catchall at the end says, "and any other property of the debtor which, upon compliance with applicable laws, would have been set aside or held for the benefit of customers."

I am not aware that when I put a hundred dollars at a broker, I'm also depositing my claims against third parties, because if that is the case, somebody better tell me that, and it's not in the statute.

The notion that customer property -- leaving aside the fiction that there is a separate Fund of Customer Property -- that customer property entitles the Trustee to sue third parties is nowhere in the statute and it's nowhere starting with the definition of customer property.

Thank you.

MR. KING: May it please the Court, Marshall King from Gibson Dunn & Crutcher on behalf of the UBS defendants.

My plan is to discuss the issues of contribution which the Trustee has raised, and if time permits or if Your Honors have any questions, the alternative ground for affirmance of SLUSA preclusion that we have argued here.

On contribution there are really three key points that I want to make: One is that there is no dispute among the parties that there is no right of contribution under SIPA or under federal common law for the claims at issue here.

The Trustee -- Judges McMahon and Rakoff both held that there was no such federal right of contribution. The Trustee does not argue otherwise here. In fact, he runs away from federal law arguing that New York law is the source of his contribution claim, which brings me to my second point, of course, which is that state law here doesn't apply because the underlying obligation for which the Trustee seeks contribution is an obligation imposed by

federal law.

The Supreme Court held in Northwest Airlines that where state law supplies the appropriate rule of decision, the court can look to state law for contribution rights and see if the state law implies those rights on behalf of a party that pays out more than its fair share, but the way the Supreme Court and this court have analyzed and assessed what supplies the rule of decision is by looking to the source of the underlying obligation for which the claimant is liable.

In Northwest Airlines the issue was a claim against the defendant under the Equal Pay Act and under Title VII and the court rightly said that, therefore, is a matter of federal law whether that defendant has a contribution claim against third parties who allegedly contributed to the injury. They held, of course, that it did not have a contribution right in that circumstance, but it does not endorse state law contribution in that circumstance.

In this court, in Herman versus RSR Security Services, the court applied Northwest

Airlines in a very similar manner. The defendant there was liable for violations of the Fair Labor Standards Act. The court first held that the FLSA did not give a right of contribution under federal -- either implied by law in the statute or under federal common law and it rejected the argument that the defendant made that he should have a state law contribution right.

It said, and I'm quoting, "here federal law, not state law, supplies the appropriate rule of decision because the instant claim has been brought solely pursuant to the FLSA."

In addition to Judges McMahon and Rakoff below and the decisions that are on appeal here, other judges in the district courts have applied and followed a similar analysis. I think Judge Mukasey's decision in LNC is a very good expression of the issue and holds -- again, I'm quoting -- "the source of a right of contribution must be an obligation imposed by state law. If the underlying obligation is one imposed by federal law, the contours of that obligation also are determined by federal law."

In applying this rule in LNC, Judge Mukasey found first that there was no right of contribution under the Trust Indenture Act. There was a claim against the defendant under the TIA that Judge Mukasey said you cannot seek contribution for that.

What he then went on to hold, though, is there was also a claim for state law breach of fiduciary duty against the defendant there, and he said for that claim you can assert a state law contribution claim.

So that's exactly what we have here -- that distinction is one that applies here, and that is that the obligation that the Trustee is required to pay here is an obligation imposed by federal law, by SIPA under the net equity obligations of the statute.

It's irrelevant -- the Trustee says, well, I've got these -- I've claims -- my state law aims are aiding and abetting claims. My state law claims arise under New York law. It's irrelevant that that's what the claimants might have against us.

What matters is what is the claim against the Trustee. The claim for which that

-- the Trustee seeks to have us contribute to, and that is what supplies the applicable rule of decision, and here that is only federal law and not state law and, therefore, state law simply has no application here.

Finally, my third point on contribution. Even if you could get to the idea that New York state law would apply, the New York state law requires that the parties seeking contribution be liable for damages, that's what the statute says, liable for damages for the same injury to property. That's CPLR 1401.

The Trustee's obligation here to distribute customer property to customers of Bernard Madoff in accordance with net equity claims is not liability for damages. It's not tort liability at all. Net equity is a mathematical formula. There are different ways one can apply it, as Your Honor held last year in the Net Equity decision, but it's a mathematical formula that does not require anyone, no customer is required to prove tort liability against the Madoff brokerage firm.

And Your Honor, in fact, in that decision made clear that we aren't talking about

-- SIPA does not protect against fraud. That is not what SIPA is designed to do. SIPA is designed to distribute money equitably when a broker/dealer goes insolvent. It is not a fraud statute.

And, therefore, the claims against the estate, the claims against the customer property fund are not tort claims. They are simply a statutory mathematical calculation.

JUDGE JACOBS: It doesn't matter why this property vanished?

MR. KING: It does not matter why property vanished. And here, of course, there is no finding that any one person, any customer has a fraud claim or is recovering on a fraud claim.

There's an interesting application of this. It's in an older case called In Re MV Securities that we cited in our papers. It's a bankruptcy court decision from 1985. There a customer of a broker/dealer brought and won an arbitration claim against the broker/dealer before the SIPC -- the SIPA insolvency proceeding started. They won an arbitration claim on the ground that the investment that was

made on behalf of the customer was unsuitable for that particular investor.

The court, however, held that that claim, that arbitration award was not a customer claim, it was not protected as part of what SIPA is designed to protect and, therefore, that person didn't have a customer claim.

Had the broker/dealer been holding securities on her behalf, she would have had a customer claim, but that's not what was at issue.

What was at issue was, similar to here, a fraud claim, a wrongful acting claim that customers might have. What Judge Abram in the bankruptcy court said, "SIPA does not protect customer claims based on fraud or breach of contract. SIPA's primary intent and policy are to protect customers who have cash and securities being held for them by a broker/dealer, rather than to serve as a vehicle for the litigation of claims of fraud or violations of Rule 10b-5."

So whether you look at this as a matter of not having a claim under federal law, if you could get to the issue of state law, you

still wouldn't have a right of contribution in the debtor here because they aren't paying tort liability, they aren't payable damages to customers.

Briefly, I want to just touch on this alternative ground for affirmance that everyone argued below was not addressed by either Judges McMahon or Rakoff but which does provide a ground for affirmance if the Court ever needs to reach it and that's SLUSA preemption, and I'll be brief on that.

There are really two issues that are in dispute: One is, frankly, rather simple, I think. It's a question of whether the fraud is in connection with the purchase or sale of a covered security. The "in connection with" requirement the Supreme Court in Dabit says is to be broadly construed, that this court in Romano said that that's satisfied if the claims necessarily allege, necessarily involve, or rest on the purchase or sale of securities. And nearly every single case at the District Court level that's looked at the Madoff case, the Madoff fraud, has held that it is in connection with the purchase or sale of securities.

There is one outlier case called Anwar. It's probably wrongly decided, in light of the overwhelming authority to the contrary, but even there the reason that Judge Marrero held that it wasn't in connection with the Madoff fraud was because there were claims by investors in feeder funds which then invested in Madoff. And he held that there was a separation between the fraud that was alleged to have defrauded these folks to invest in the feeder fund and from the covered securities that Madoff was supposed to be buying. Here none of that, of course, is present. The claims he's bringing are on behalf of customers directly.

The more interesting question is whether this is a covered class action. And here we do think that it is because these claims are literally being brought on behalf of customers. It is not just that customers will benefit by a recovery to the estate. These are being brought on behalf of those customers.

The counting provision of SLUSA, which the Trustee and SIPC rely on, simply aren't relevant. The Trustee may well be one person, but the claims he's bringing are on

behalf of more than 50 -- more than 50 customers.

The Trustee calls the counting provision, he calls it an entity exception or an entity exemption, and there is some case law that uses that term, but the statute doesn't say it's an exception, the statute doesn't call it an exemption. The statute says this is how you count people. And if you're a corporation or a trustee and you aren't organized solely for the purpose of bringing the claim -- or for the purpose of bringing the claim -- it doesn't have to be solely -- you are one person, but if you are bringing the claims on behalf of more than 50, it's a covered class action, just as any class plaintiff, any named class representative is one person, but if they bring a class action on behalf of more than 50, then SLUSA applies and precludes the claims.

JUDGE JACOBS: Thank you.

MR. KING: Thank you, Your Honor.

JUDGE JACOBS: Welcome.

MR. VELIE: Good afternoon, Your Honor.

I'm Frank Velie, may it please the

Court, from Sullivan & Worcester. I represent UniCredit Bank Austria in Docket 5175. And I'm here to argue for another alternative holding for why the case was properly dismissed, and that is the Trustee lacks Article 3 standing.

This argument applies not just to Bank Austria but to UniCredit S.p.A. and Pioneer, our co-defendants in 5175, the HSBC defendants in 5207, and the UBS defendants in 5051.

To set the stage. What is it that we are alleged to have done? We are alleged -- these moving defendants are alleged -- I should say these Appellee defendants are alleged to have provided services to certain foreign feeder funds, and that in that connection, we missed the significance of certain red flags which are alleged, and the result of that was that foreign investors put their money into the feeder funds and the feeder funds in turn put their money into Madoff.

Now, as you might imagine, this has created a number of disputes between the investors into the foreign feeder funds and us. We are being sued not only here where there was

a class action which was recently dismissed on forum nonconvenience grounds, but there are numerous, numerous actions against these defendants all over Europe and elsewhere, and those actions have not been stayed. We are defending those actions.

The Trustee is a stranger to this dispute. How is it that we are being sued here? He claims, well, when we did this and this resulted in money being invested in the feeder funds, there was an influx of cash into BLMIS. Well, how does that injure BLMIS? It's hard to see if Judge Rakoff couldn't see how that created an injury. And if you look at their tag word, which is deepening insolvency, that provides no help either. If you take a look at the cases collected -- quite nicely, I thought, about Judge Kaplan in the Refco case -- where you have money going into a person that might be insolvent, it creates a debit and a credit, an asset and a liability. They're in perfect balance. That doesn't deepen the insolvency.

What deepened the insolvency? The subsequent act of Mr. Madoff who misapplied and misappropriated the money. He's a third -- he's

a foreigner to this dispute between us and -- if there is a dispute -- between us and these feeder fund people.

And, of course, there's harm to the customers, Mr. Madoff's customers, but that harm was caused solely by Mr. Madoff. We put the money in and if Mr. Madoff had not subsequently, as I say, misapplied or misappropriated, it would still be there along with their money.

JUDGE JACOBS: Your standing argument is starting to merge with the merits.

MR. VELIE: Indeed that can happen. There is a lot of causation which is baked into standing. The rule, accurately stated, I think -- or at least for our purposes -- is -- the rule we need to follow is the one that's articulated or at least endorsed by this court in the St. Pierre case in 2000, and that is the plaintiff must show harm to himself, fairly traceable to the acts of the defendants, which are complained of, and which is not the result of an independent act of a third-party or here a first party, Mr. Madoff.

So, inevitably, there's going to be overlap between causation for whatever purposes

causation is used and for standing, but here where there is no injury whatever and the dispute is one -- if there is one -- about what we did and whether it was right or wrong is really a dispute between us and investors in the feeder funds. The Trustee is a stranger to this, and for that reason we argue lacks standing.

That's basically the argument I want to make and it goes this way. If there's no injury, there's no standing. If there's no standing, there's no case or controversy, and, therefore, no subject matter jurisdiction in this court.

So this is an alternative ground applicable to these defendants.

JUDGE JACOBS: Thank you.

Any rebuttal?

MR. WARSHAVSKY: A lot. Thank you.

I want to start by discussing Redington and maybe just -- well, actually I'll start by -- Redington is the law of this circuit. A district judge is not allowed to overturn the law of this circuit. Ultimately when the defendants say, a-ha, it was vacated,

the first time the argument that Redington was vacated was ever made was to this court, and it was by virtue of a copy of an order which we cannot find in the file.

We first saw this when we got the defendants' briefs. It wasn't argued below, it wasn't argued in BDO. Everybody until these briefs were filed in this case understood Redington to be the law of this circuit, and that includes this court.

In the BDO case -- and we cite to it -- it's very clear. Now Justice Sotomayor said Redington is the law of this circuit. Even if --

JUDGE JACOBS: Well, that was assumed.

MR. WARSHAVSKY: I'm sorry?

JUDGE JACOBS: I think she assumed it to be in that case.

MR. WARSHAVSKY: Well, that's right, but what else would she -- I guess the question is, Your Honor, what else would she look to?

JUDGE JACOBS: It's odd to say of a current case that it's assumed to be the law of

the circuit if it's the law of the circuit. There's a controversy about it, I mean, it's impaired, it's -- it has dubious aspects to it at this stage.

MR. WARSHAVSKY: Well, I guess the first point I was speaking to is that it was always understood to be the law of the circuit and whether or not it was questioned -- even BDO said it could only be reversed by the Supreme Court or by a full -- by a panel of this court, and that's how it was understood. We've argued to you why we think it is good law, nonetheless, but I did want to start there.

I want to address then Mr. Savarese's argument about SIPA being only a payment scheme and the Fund of Customer Property only being a payment scheme. What I would point to is the statue itself in 78fff-2(c)(1). And that is the provision of what happens when the Fund of Customer Property is not replenished but there's money in the general estate. And what the statute says is that at that point a customer claim -- the customer's net equity claim is treated just like a general creditor.

If SIPA is only a priority scheme,

why would a customer's net equity claim be treated similar to all the claims of a creditor? If in this case no money could be brought back into the estate -- let's remember, in this case, when this case first broke, people weren't expecting the Trustee to be able to bring as much money -- very much money back in at all, and it's questionable whether the Trustee will be able to bring all the money back in, but if Madoff was running another business, if there was another general estate, all these customers would participate just like general creditors. The reason again, I would submit to Your Honors, goes back to the definition of customer property. What is customer property? It's property that never belonged to the debtor.

Redington -- we say in our papers that Redington is a judicial expression of the law, because, as you point out, the statute doesn't say bailment, but a broker/dealer and a SIPA Trustee and the debtor don't have an ownership interest in customer property, they never did. All any of those entities have is a right of possession and they own it -- I'm sorry -- and the property itself is always owned by

the customers, but, again, it's -- the Fund of Customer Property is far more than a payment scheme.

I'd also -- Wagoner was touched upon, but I'd also like to discuss why Wagoner would be inappropriate in the context of a bailment like this. And it's not an overarching policy and it actually goes to the definition of customer property and the definition of customer.

The Kirschner case, the New York Court of Appeals was very clear. It said, look, there could always be good policy ground, people could always argue policy for why one set of creditors should profit over another set of creditors. We don't have that here.

Again, we go to the definition of customer. The definition of customer excludes creditors, it excludes shareholders and it goes a step further. It excludes anybody who's a capital investor even if they're clean, even if there was no fraud here, even if Wagoner never claim into play, none of those entities could ever recover from the Fund of Customer Property.

That's why I think Wagoner and in

pari delicto should never apply to the Fund of Customer Property or Trustee seeking to recover money for the Fund of Customer Property.

JUDGE CARNEY: Could you also address your adversaries' argument about the definition of customer property that's in the statute that, as I understood he was saying, it didn't include choses in action, it's just securities or cash, therefore, that you don't have control over their claims?

MR. WARSHAVSKY: Well, customer property is -- the definition is whatever was supposed to be segregated and anything that actually was segregated. It includes anything that the debtor wrongfully converted and put into the debtor's property. It also includes anything that the Trustee can bring back into the estate.

So customer property always includes, for instance, the avoidance actions of the Trustee. If the Trustee sees that money -- that one customer's money has gone to a second customer, the Trustee can always bring an avoidance action to try and bring that money back into the estate. If the Trustee wins the

case, wins the avoidance action, that money that's brought back in doesn't go to the general estate, it goes to the customer property fund. So that's the definition of customer property.

My adversary is right, there is no definition -- there's nothing in the definition of customer property that says, a-ha, any third-party claim could be brought, obviously, but it does bring in any property of the debtor, and to the extent a debtor has a third-party claim, certainly that would be included as property of the debtor which could be brought back into the estate.

In that regard, I guess as long as we're talking about third-party claims, I'm going to skip to Mr. King's argument. Mr. King said, well, SIPA doesn't allow for state law claims. No one here has ever debated that the Trustee has a right to bring causes of action under the New York Debtor Creditor Law, no one has ever questioned that.

In point of fact, if Madoff had had innocent insiders, no one would have questioned whether or not he could -- there might be exceptions to in pari delicto to bring actions

under the Bankruptcy Code because he invested with those powers.

What we've done here is we've said any defense that exists under Chapter 11 is going to be imported into SIPA. That's really what is -- SIPA statute doesn't speak to any types of causes of action, but I'll take that a step further, which is, a typical bankruptcy trustee can, regardless of in pari delicto, could bring a cause of action for contribution. Why wouldn't a SIPA Trustee be able to bring that -- why would a SIPA Trustee now have less rights than a bankruptcy trustee? That makes no sense. That can't be what customer protection means.

I want to go to -- I'm sorry to speak so quickly.

You had asked for a cite before, Your Honor. We had cited in our papers the Klinger case, which is 41 N.Y.2d 362, which cites McCabe v. Queensboro, which is 22 N.Y.2d 204, two cases, I believe both from the New York Court of Appeals -- I assume from the cite they're both from the New York Court of Appeals -- that held that a defendant has a

right to bring a claim of contribution prior to recovery.

I want to touch briefly on the arguments by Mr. Moloney and Mr. Velie, and they focus on facts and facts outside of this case.

The Trustee absolutely has brought causes of action that he alleges harm the entire estate. For the purposes of this action, those have to be deemed true. To the extent we're talking about causation, I gave one example before, unfortunately, my time is limited, but if you were to read our complaints, I think we articulate exactly why. And just if I could maybe give a very simple hypothetical, which is, if you were a customer of Madoff and Madoff was on the precipice of collapse in 2001, 2003, various times, and new money came in, the entire Ponzi scheme is prolonged. You don't have to know why it's prolonged, you don't have to know the identity of those that aided and abetted the scheme to have a cause of action for damages. Rather, you're damaged by the fact of the prolonging of the scheme.

To that end, any -- I don't think anyone would question that anybody who helped

Madoff inside, people who have confessed to helping Madoff and are being sentenced, or perhaps in jail already, certainly they were strangers to customers, certainly nobody knew their names ahead of time, certainly there was no relationship ahead of time.

The way they were injured and the reason they could proceed is because there was an intentional tort and they were damaged. They don't need to show a relationship. All they need to show is that they were injured by that defendant's conduct.

I want to touch again -- I'm sorry to hop all over. You gave a lawnmower example earlier about what happens to a lawnmower in a bailment. The first thing I'd say is, to counter some of the arguments by the defendants is, no matter what in that example, the lawnmower was not an juridical entity. That's not the touchstone for whether a bailment exists or whether a bailee could bring an action or the bailor, frankly, for damage to the bailed property.

The difference is in a case like this, if you put your lawnmower with Madoff, you

would not share with creditors, you would not be treated pro rata with creditors. You would get your property back. And if we had to bring a separate action, if the Trustee brought a separate action on your behalf, it would be to get back that property.

I see my time is up. If I could address St. Paul --

JUDGE JACOBS: Go ahead.

MR. WARSHAVSKY: Okay. Now I'm sorry for speaking so quickly.

JUDGE JACOBS: Well, it's mainly a problem for our court reporter. Don't speed up.

MR. WARSHAVSKY: I'll try not to.

When we talk about St. Paul -- and you had asked earlier about who owns the claim -- and what St. Paul said -- and I don't think what Appellees disagree -- St. Paul said that if any creditor could bring the claim, it becomes property of the estate, and that's not the only case to hold that and it's for good cause, because the whole purpose of the Bankruptcy Code or the SIPA statute, for that matter, is to avoid a rush to the courthouse, to avoid various claims, and, frankly, it makes a

lot of sense from a judicial economy standpoint not to have 4900 different plaintiffs suing various defendants because of the same common injury. It also is in keeping with a pro rata distribution.

It's why -- and Your Honor had addressed the automatic stay in the context of St. Paul. In fact, we brought claims in that regard here. I would point Your Honors to the decision in Fox v. Picard, we cited it in our papers, but there what the court held is that St. Paul has broader implications than just a debtor's alter ego.

St. Paul is -- the reason St. Paul comes into play is because the -- you use the term a general versus particularized claim.

Every --

JUDGE JACOBS: I'm not sure what it means but -- in general.

MR. WARSHAVSKY: And I think St. Paul or Fox and other cases that have interpreted St. Paul speak to that, which is that at the moment of insolvency, every Madoff customer suffered the same injury. They didn't suffer it to the same degree, but they suffered

by the virtue of the same injury because of the insolvency.

To the extent they have claims, for instance, against Bernard Madoff or, in a case of St. Paul, against the debtor's alter ego, well, everybody has been damaged equally, and that's really the touchstone of the Trustee's claims here, is that anybody -- these defendants aren't the only defendants where the Trustee has made these allegations. He's also made allegations against the accountants, against others who helped propagate this scheme.

And the point goes back to my position with you earlier, Your Honor, which is that anybody who suffered by their -- by virtue of this fraud suffered -- their suffering was increased each time the scheme was prolonged, each time the scheme was propagated.

And our position is that those that helped propagate the scheme, those that we have accused of aiding and abetting the fraud and helping to propagate it, should pay their fair share.

I'd say also, frankly, when we're discussing Wagoner and its progeny as well, I

spoke about customer. I also harken back to Your Honor's Net Equity decision here.

Here what we're talking about is bringing back investors their principal. We're not talking -- we keep talking about damages. I know that's the only way to think about it, but we're not talking about expectation damages or anything. All we're talking about here is filling the Fund of Customer Property, getting back each investor, some who were 30, 40 years in Madoff back to sea level. That's all we're doing.

Thank you. Thank you for the extra time.

MR. LA ROSA: I just wanted to make a couple of additional points, Your Honors. In thinking about bailment, I just encourage you, as I said at the beginning of my presentation, to go back and look at the really very simple elements that are necessary to create a bailment applied under the law. It's lawful possession and a duty to account for the bailed property as the property of another. Both of those elements are pretty clearly satisfied here. You've got lawful possession per 15c3-3 and you've got a

statute -- first a regulatory and then a statutory duty to account for this as property to another. That's, I think, clear on the basis of both the regulation and the statute.

There's a lot of talk about the real bailment being customer named securities, not customer property. And that is really --

JUDGE JACOBS: But there's something to that --

MR. LA ROSA: Well -- go ahead.

JUDGE JACOBS: -- because if a raincoat is dropped off at the dry cleaner, you expect the dry cleaner to handle and clean the raincoat. You don't expect the dry cleaner to wear it.

MR. LA ROSA: Well, that's true but --

JUDGE JACOBS: And if you deposit securities with a broker, with a broker/dealer, they can use it for various purposes.

MR. LA ROSA: Well, but they always have to have like securities in their possession or control reserved for you, right? I mean, they can't -- yes, they can use the particular securities -- it just really points out the

distinction between non-fungible and fungible property. Customer name security is a security that's non-fungible, it's registered in your name particularly.

A street name security which is held in the name of the broker/dealer but can be used in -- you know, as long as the broker/dealer has -- if the broker/dealer owes 50,000 shares of IBM to it customers, so long as it has at least 50,000 shares of IBM available for delivery to its customers --

JUDGE JACOBS: So that's going back to the grain silo?

MR. LA ROSA: Yes, it's -- effectively it's just the application of bailment principles to fungible property, which is what street name securities are, they're securities that are held in the name of the broker/dealer for the benefit of the broker/dealer's customer. Typically, you know, broker/dealer would have an omnibus account at a clearing corporation in which it would hold all of the securities that it's holding for customers and then it would allocate those securities to individual customers on its own

books and records.

But the fact -- I mean, if your -- the raincoat example is a little difficult because it may be a very special raincoat to you, but, I mean, if it were a raincoat -- if you didn't care particularly about the make or, what have you, of that raincoat, just so long as the cleaners gives you back an identical raincoat, one that's functionally equivalent, you wouldn't care. It would be --

JUDGE JACOBS: Well, I'm not sure about that.

MR. LA ROSA: Well, it may be non-fungible. The point is that the statute recognizes a distinction that's implicit in bailment law between non-fungible and fungible property. The fact that it has different rules applying to fungible property doesn't mean that a bailment isn't created. It just means that it's a bailment relating to non-fungible -- to fungible property and that the rules are different there.

With regard to Wagoner, I don't know that the case was even mentioned, but we've relied very heavily on the Bateman Eichler

doctrine.

Wagoner is based on a -- is a transposition of the state law defense of in pari delicto to federal standing, but effectively it is an adoption of that defense. There's no distinction that we can discern between the contours of the federal standing doctrine under Wagoner and the state law defense of in pari delicto.

There is a line of cases decided by the Supreme Court starting with Bateman Eichler, to the effect that when a state law defense, an equitable defense like in pari delicto, would interfere or frustrate the goals or purposes of the federal statutory or regulatory scheme, then it's not applicable, it's displaced. We think that principle is applicable here.

The primary, if not the exclusive purpose of Rule 15c3-3 --

JUDGE CARNEY: Excuse me. Would that also apply -- would that argument also apply to a regular Chapter 7 bankruptcy trustee or just special to SIPA?

MR. LA ROSA: Well, I mean, depending upon the context it could, but there

are particular purposes that Rule 15c3-3 and SIPA have that would be deeply frustrated by the application of in pari delicto. There's a bailment that's created by those provisions. That bailment enables the Trustee to recover customer property. Look, the over -- the principal, if not the only purpose really of 3-3 and SIPA is to ensure that customers get back the property that they've entrusted to a broker/dealer, that the broker properly performs its custodial function and if it doesn't, that customers don't suffer because there's been a breakdown in that custodial function.

If you -- if you say that a Trustee who had no part in the wrongdoing of a broker/dealer is still tainted by the broker/dealer's participation in that wrongdoing and, therefore, can't recover as a result of it, you would be prohibiting the Trustee from recovering property that would be ultimately allocated and distributed to customers for their benefit. It would frustrate the primary -- it is called the Securities Investor Protection Act. It would frustrate the primary goal of the statute and the regulation to apply the

doctrine, and so we think Bateman Eichler displaces Wagoner in this context.

JUDGE JACOBS: Thank you.

MR. LA ROSA: Thank you.

JUDGE JACOBS: Thank you all.

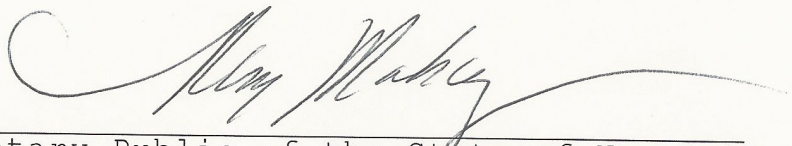
The Court is grateful to counsel for expert argument on all sides. We will reserve decision.

(Time noted: 12:40)

C E R T I F I C A T E

I, NANCY MAHONEY, a Certified Court Reporter and Notary Public of the States of New Jersey and New York, do hereby certify that the foregoing is a true and accurate transcript of the proceedings as taken stenographically by and before me at the time, place, and on the date hereinbefore set forth.

I DO FURTHER CERTIFY that I am neither a relative nor employee nor attorney nor counsel of any party in this action and that I am neither a relative nor employee of such attorney or counsel, and that I am not financially interested in the event nor outcome of this action.



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